

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:LM:CTM:LN:TL-N-1917-01

JMMarr

date:

to: Janice Martin, LMSB 1751, Long Beach

from: June Y. Bass, Associate Area Counsel (LMSB)  
Joyce M. Marr, Attorney

---

subject: [REDACTED], A Corporation  
Income Tax Years [REDACTED] and [REDACTED]  
TIN - [REDACTED]  
Restricted Consent Language

Statute of Limitations: [REDACTED] -- [REDACTED]  
[REDACTED] -- [REDACTED]

**DISCLOSURE STATEMENT**

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

This memorandum responds to your request for assistance dated March 19, 2001, requesting our review of the language on a draft Form 872 (Consent To Extend The Time To Assess Tax) for the years ending ended December 31, [REDACTED] and December 31, [REDACTED]. This memorandum should not be cited as precedent.

**ISSUE**

Whether Counsel approves of the restrictive language contained on the draft Form 872?

**CONCLUSION**

To accomplish your purpose, we recommend the restrictive language below. The restrictive language on the consent form should be placed in the space between the printed text of the form and the first signature line. However, if space is limited, the restrictive language can be placed on an attachment and "SEE ATTACHED STATEMENT" should be placed in the space between the printed text and the first signature line of the restricted consent form.

The restrictive language on the Form 872 should read as follows:

The amount of any deficiency, penalty, setoff, addition to tax and/or interest assessment shall be limited to that resulting from any adjustments to: (1) the section 481 adjustments for [REDACTED] and [REDACTED]; (2) the deduction claimed for bad debts for [REDACTED]; and (3) interest income on nonperforming loans for [REDACTED] and [REDACTED], including any consequential changes to other items based on any such adjustments.

As used herein, the term "adjustment" means any change or changes to said item(s) whether reported or not reported on the return. The change can be in amount, taxable status, allocation, character, etc.

As used herein, the term "consequential changes" means any direct or indirect effect.

As used herein, the term "nonperforming loans" means "loans on which a loan payment was more than 90 days past due and with respect to which the Taxpayer had ceased to accrue interest for regulatory purposes."

A footnote limiting the application of I.R.C. § 6511(c) should be added to the consent stating, "The provisions of section 6511(c) of the Internal Revenue Code are limited to any refund or credit resulting from adjustment(s) for which the period for assessment is extended under this agreement."

Since the requirements of I.R.C. § 6501(c)(4)(B) pertaining to giving the taxpayer notification of certain rights must be satisfied, please ensure that the statute extension is requested by the most recent revision of the appropriate Form Letter 907 or 967.

## FACTS<sup>1</sup>

[REDACTED], A Corporation (the Taxpayer) is an accrual basis, calendar year taxpayer. On [REDACTED], the Service issued a letter ruling permitting the Taxpayer to change its method of accounting for interest on nonperforming loans<sup>2</sup> beginning with its [REDACTED] tax year. Prior to the change of method of accounting, the Taxpayer's practice was to cease accruing interest on nonperforming loans once a loan payment was more than 90 days past due. Under the new method, the Taxpayer is required to accrue interest "until either the particular loan is charged off or the interest is determined to be uncollectible." The letter ruling indicates that interest on a loan is treated as uncollectible only if, "taking into account all the facts and circumstances, .. [the Taxpayer] has no reasonable expectation of payment of the interest."

The Taxpayer calculated its section 481 adjustment as \$[REDACTED]. The letter ruling permitting the change in accounting method required the section 481 adjustment to be taken into account ratably over [REDACTED] taxable years commencing with [REDACTED]. Accordingly, in each of the years [REDACTED] and [REDACTED], the Taxpayer included [REDACTED] of the section 481 adjustment, or \$[REDACTED], in income.

The Taxpayer's section 481 adjustment of \$ [REDACTED] included interest on loans which were worthless at the end of [REDACTED]. The Taxpayer maintains that because it had neither determined the uncollectibility of such interest nor charged off the loans prior to [REDACTED], all the interest accrued on the nonperforming loans that it had not reported under its prior method must be included in the section 481 adjustment.

<sup>1</sup>Unless specifically noted, we have relied upon facts presented to us orally and in writing by the Examination Division. Our advice might be different if the facts were different. If the facts which we recite in this memorandum ultimately prove to be inconsistent with your understanding of the facts, or if we have recited facts of which you are not aware, contact this office immediately and do not rely on this memorandum.

<sup>2</sup>Nonperforming loans are those loans on which a loan payment is more than 90 days past due and with respect to which the Taxpayer has ceased to accrue interest for regulatory purposes.

the Examination Division maintains that: (1) \$ [REDACTED] was uncollectible before [REDACTED] and, therefore, should not have been included in the section 481 adjustment and deducted in [REDACTED]; and (2) \$ [REDACTED] should not have been deducted in [REDACTED] since the value of the collateral was greater than the outstanding principal balance as of [REDACTED]. It is the Examination Division's position that the Taxpayer's method of valuing the collateral is improper since it takes into account such factors as estimated disposition costs and forced sales value.

The Examination Division has maintained in the alternative that the Taxpayer's partial bad debt deduction for tax year [REDACTED] is limited to the amount of the section 481 adjustment included in income, i.e., \$ [REDACTED].

Under its new method of accounting, the Taxpayer accrued interest income of \$ [REDACTED] on nonperforming loans for [REDACTED]. Of this amount, it deducted \$ [REDACTED] as partially worthless debt in the same year. The \$ [REDACTED] treated as bad debts includes \$ [REDACTED] of interest which the Exam Division believes was not worthless at [REDACTED] year-end.

The Taxpayer and the Examination Division sought Technical Advice on essentially the following issues: (1) whether the method used by the Taxpayer to assess the worthlessness of loans and/or assess the uncollectibility of interest payments is an acceptable approach; (2) whether the Taxpayer was required to assess the worthlessness and/or collectibility of interest on its nonperforming loans as of [REDACTED], in computing the section 481 adjustment; (3) whether the Taxpayer correctly included interest on nonperforming loans that were uncollectible as of [REDACTED], in its section 481 adjustment; (4) whether the amount which the Taxpayer is entitled to deduct in [REDACTED] for interest on partially worthless debts included in its section 481 adjustment is limited to \$ [REDACTED]; and (5) whether \$ [REDACTED] of the deduction claimed for interest income accrued in [REDACTED] as partially worthless debts in that same year should be disallowed due to the Taxpayer improperly valuing the collateral securing its loans.

On or about [REDACTED], the IRS issued a technical advice memorandum (TAM-125014-00), a copy of which is affixed hereto and incorporated by reference.

As a result of the conclusions reached in the TAM, the Examination Division intends to propose adjustments to the Taxpayer's returns for [REDACTED] and [REDACTED] as follows:

(1) a reduction of the section 481(a) adjustments included in income for [REDACTED] and [REDACTED] as a result of excluding interest that was uncollectible at the end of [REDACTED] from the section 481(a) adjustment required as a result of the Taxpayer's change in the method of accounting for interest income on its nonperforming loans;

(2) a reduction of the bad debt deduction for [REDACTED] to eliminate bad debt expense for interest on loans that was uncollectible at the end of [REDACTED];

(3) a reduction of the bad debt deduction for 1996 to eliminate bad debt expense for interest on loans which is collectible based on the payment history of the borrowers and the method of valuing collateral approved in the TAM;

(4) increases to interest income for [REDACTED] and [REDACTED] to include interest income on nonperforming loans which is collectible based on the payment history of the borrowers and the method of valuing collateral approved in the TAM; and

(5) a decrease to interest income for [REDACTED] to exclude interest received and reported by the Taxpayer as income from nonperforming loans in [REDACTED], which the Taxpayer failed to properly accrue and report as income prior to [REDACTED] since it had concluded, based on its valuation method, that it had no reasonable expectation of payment of the interest.<sup>3</sup>

The Taxpayer has agreed to an extension of the period for assessment for the tax years [REDACTED]<sup>4</sup> and [REDACTED], since it plans to exercise its Appeal rights. However, the Taxpayer wishes to limit the scope of the extension of the statute of limitations to potential adjustments resulting from the issues considered in the TAM. You have asked that we review the language on a draft Form 872 which you have prepared to so limit the scope of the extension.

---

<sup>3</sup> A net decrease of \$ [REDACTED] to interest income is proposed by the Exam Division for [REDACTED], which is composed of both the decrease to interest income described in paragraph (5) above and the increase to interest income described in paragraph (4) above.

<sup>4</sup> The Taxpayer previously agreed to an extension of the period for assessment for tax year [REDACTED]

Immediately below the printed text on the front page of the draft Form 872, you have inserted the following restricted consent language:

The amount of any deficiency assessment is to be limited to that resulting from any adjustment to (a) interest on non-performing loans; (b) bad debts; and (c) section 481 adjustments; including any consequential changes to other items based on such adjustments.

#### DISCUSSION

I.R.C. § 6501(a) provides the general rule that tax must be assessed within 3 years after the return was filed. However, I.R.C. § 6501(c)(4) provides that where the Secretary and the taxpayer have consented in writing to the assessment of tax after the time prescribed in section 6501, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. Form 872 may be used for this purpose.

There is considerable authority for the use of restricted consents, which extend statutory periods of limitations on assessment only with respect to issues specified therein, in various judicial decisions. See Commissioner v. Callner, 287 F.2d 642 (7th Cir. 1961); and Loeser v. Commissioner, 27 B.T.A. 601 (1933).

We recommend the restrictive language set forth under the heading "CONCLUSION" above be used to describe the areas of potential adjustments. In the event it becomes necessary to use different rationale than that set forth in the TAM in making the adjustments, the restrictive language will not foreclose the utilization of different rationale. IRM 121.2.22.8.11. The definitional paragraphs which we have recommended should prevent any later disagreements between the Service and the Taxpayer as to the meaning of the defined terms.

In an abundance of caution, to avoid potential litigation regarding whether the restricted consent is applicable to any penalties or additions to tax (See Marx v. Commissioner, 13 T.C. 1099 (1949)), we recommend that the portion of the restricted consent language on the draft Form 872 which refers to "[t]he amount of any deficiency assessment" be modified to refer to "[t]he amount of any deficiency, penalty, addition to tax and/or interest assessment."

I.R.C. § 6511(c) provides, with certain limitations, that if a statutory waiver is executed pursuant to I.R.C. § 6501(c)(4) extending the period for assessment of tax, the period for filing a claim for credit or refund shall not expire before six months after the expiration of the period within which an assessment may be made pursuant to the agreement or any extension thereof. When restricted language is used in a consent, a footnote limiting the application of I.R.C. § 6511(c) should be added to the consent stating, "The provisions of section 6511(c) of the Internal Revenue Code are limited to any refund or credit resulting from adjustments for which the period for assessment is extended under this agreement." See IRM 8.2.1.3.3.12.

We have coordinated this advice with National Office under the NSAR pre-review procedures. With the rendition of this advice, we are closing our file. If you have any questions concerning the above, please contact the undersigned at (949) 360-2688.

---

JOYCE M. MARR  
Attorney